



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/10/06	Bill No:	AB 2013
Tax:	Alcoholic Beverage	Author:	Saldana
Related Bills:	AB 417 (Aghazarian)		

BILL SUMMARY

This bill would require the Board of Equalization (Board) to calculate the total amount of all surtaxes, interest, and penalties collected as a result of the reclassification of any alcoholic beverage from a beer to a distilled spirit in order for those amounts to be transferred to the Youth Alcohol Problem Prevention Fund (Fund).

ANALYSIS

Current Law

ALCOHOLIC BEVERAGE TAX LAW

Under current law, Sections 32151, 32201, and 32220 of the Alcoholic Beverage Tax Law impose the following taxes and surcharges on the sale of beer and distilled spirits:

	<u>Tax</u>	<u>Per Gallon Surcharge</u>	<u>Total</u>
Beer	\$0.04	\$0.16	\$0.20
Distilled spirits (100 proof)	\$2.00	\$1.30	\$3.30
Distilled spirits (100+ proof)	\$4.00	\$2.60	\$6.60

For purposes of the Alcoholic Beverage Tax Law, the terms “distilled spirits” and “beer” are defined in Sections 23005 and 23006, respectively, of the Business and Professions Code to mean the following:

- **Distilled spirits** - an alcoholic beverage obtained by the distillation of fermented agricultural products, and includes alcohol for beverage use, spirits of wine, whiskey, rum, brandy, and gin, including all dilutions and mixtures thereof.
- **Beer** - any alcoholic beverage obtained by the fermentation of any infusion or decoction of barley, malt, hops, or any other similar product, or any combination thereof in water, and includes ale, porter, brown, stout, lager beer, small beer, and strong beer but does not include sake, known as Japanese rice wine.

The alcoholic beverage tax is paid to the Board, which is transmitted to the State Treasurer for deposit in the State Treasury to the credit of the Alcohol Beverage Control Fund. Moneys in that fund are drawn for refunds or transferred to the General Fund. The surtax is paid to the Board, but deposited directly into the General Fund.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

Proposed Law

This bill would amend Section 32230 of the Revenue and Taxation Code to require, for calendar years beginning on and after January 1, 2006, the Board to calculate, on a quarterly basis, the total amount of all surtaxes, interest, and penalties collected as a result of the reclassification of any alcoholic beverage from a beer to a distilled spirit. All surtaxes, interest, and penalties calculated by the Board would be transferred to the Fund, which this bill would create.

This bill would become effective immediately as an urgency statute.

Background

In order to bridge the gap between revenues and expenses in the 1991-92 state budget, a surtax was added to the existing excise tax on alcoholic beverages. Assembly Bill 30 (Chapter 86, 1991) added the alcoholic beverage surtax under current Section 32220, effective July 15, 1991.

Last year, the Legislature passed Assembly Bill 417 (Aghazarian), which would have revised the definition of beer to include any alcoholic beverage that qualifies as a malt beverage under specified federal law. However, that measure was vetoed by the Governor. The Governor's veto message states, in part, the following:

"I encourage all interested parties, particularly health professionals, law enforcement and the producers of flavored malt beverages, to use this opportunity for public debate and serious consideration of the policy issues surrounding this beverage."

In General

Upon the repeal of prohibition in 1933 and the return of the legal sale of alcoholic beverages in California, taxation and regulation of the manufacture, distribution, and sale of alcoholic beverages were given to the Board. In 1955, an amendment to the State Constitution became effective removing the duty of regulating the manufacture and sale of alcoholic beverages from the Board and placing it in the new Department of Alcoholic Beverage Control.

Article XX, Section 22 of the California Constitution provides, in part:

The Department of Alcoholic Beverage Control shall have the exclusive power, except as herein provided and in accordance with laws enacted by the Legislature, to license the manufacture, importation and sale of alcoholic beverages in this State, and to collect license fees or occupation taxes on account thereof.

[¶] . . . [¶]

The State Board of Equalization shall assess and collect such excise taxes as are or may be imposed by the Legislature on account of the manufacture, importation and sale of alcoholic beverages in this State.

The Board does not independently register taxpayers under the Alcoholic Beverage Tax Law. The Board relies on ABC's classification of such persons in its administration of the Alcoholic Beverage Control Act since the Board does not currently possess the expertise or resources to independently analyze any particular alcoholic beverage to determine its composition.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author and is intended to provide funding for local law enforcement programs designed to reduce unlawful distribution of alcoholic beverages to minors and to educate the public regarding the risks associated with underage consumption of alcohol.
2. **How much of the surtax would be transferred to the Fund?** This bill would require all surtaxes, interest, and penalties collected as a result of the reclassification of any alcoholic beverage from a beer to a distilled spirit to be transferred to the new Youth Alcohol Problem Prevention Fund. Board staff interprets this language to read that the entire one dollar and thirty cents (\$1.30) per gallon surtax on distilled spirits be transferred to the new fund. However, the author intends for only one dollar and fourteen cents (\$1.14) for each gallon of alcoholic beverage reclassified, which is the difference between the distilled spirits surtax (\$1.30) and beer surtax (\$0.16), to be deposited into the new fund.

As such, staff recommends amending the bill to clarify the author's intent. Board staff is willing to work with the author's office in drafting appropriate amendments.

3. **Who would transfer the surtax, interest and penalties amounts to the Fund?** Revenue and Taxation Code Section 32230 requires the Board to deposit all surtaxes, interest, and penalties paid into the General Fund. This bill would require all surtaxes, interest, and penalties collected that are the result of the reclassification to be transferred from the General Fund to the Fund. However, the bill does not specify the agency responsible for this transfer.

This bill should be amended to specify the agency responsible for the transfer of funds and to make clear the Board is to provide that agency with its quarterly calculation.

4. **The Board could not provide a quarterly calculation retroactively.** This bill would require the Board, for calendar years beginning on and after January 1, 2006, to calculate, on a quarterly basis, the total amount of all surtaxes, interest and penalties collected as a result of any alcoholic beverage reclassified from a beer to a distilled spirit. For the Board to calculate this amount, the alcoholic beverage tax return would have to be revised to capture pertinent data regarding the specific alcoholic beverage that has been reclassified. The Board's current distilled spirits tax return captures the number of gallons for 100 proof and under and over 100 proof, but does not capture any information related to a specific alcoholic beverage.

Therefore, if an alcoholic beverage is reclassified from a beer to a distilled spirit during the 2006 calendar year, the Board would have no way of determining the total amount of surtaxes, interest and penalties related to that particular alcoholic beverage back to January 1, 2006.

COST ESTIMATE

Some administrative costs may be incurred in rewriting computer programs, revising returns, processing additional return information, and answering taxpayer inquiries. A detailed estimate of these costs is pending.

REVENUE ESTIMATE**Background, Methodology, and Assumptions**

There has been some consideration given to reclassifying flavored malt beverages as a distilled spirit rather than as a beer. If that were to occur, then there would be an increase in the amount of excise tax collected. According to the provisions of this bill, the portion of the funds derived from the surtax on distilled spirits (at a rate of \$1.30 per gallon) would be deposited in the Youth Alcohol Problem Prevention Fund. The balance of the funds (at a rate of \$2.00 per gallon) would remain in the General Fund.

According to beverage industry reports from calendar year 2001 to calendar 2003, flavored malt beverages account for 2.5% to 2.7% of the U.S. beer market. In fiscal year 2003-04, reported taxable gallons of beer to the Board amounted to 670,944,000 gallons. From this, we estimate that 17,445,000 gallons were for flavored malt beverages (2.6% x 670,944,000).

The current tax rate on beer is \$0.20 per gallon, while the current tax rate on distilled spirits under 100 proof is \$3.30 per gallon. This would be an increase in the tax rate on those products of \$3.10 per gallon. A rate increase this large will cause a decline in consumption. The price elasticity of alcohol is usually very small, in the range of -0.1 to -0.2. Also, the price elasticity is different for off-sale (purchased for consumption off the premises) and on-sale (purchased for consumption on the premises) consumption of alcoholic beverages. The higher rate will increase the off-sale price by about 23.5% and the on-sale price by about 12.5%. Applying the price elasticities to these price increases gives a decline in consumption of 4.7% for off-sale sales and 1.3% for on-sale sales. Overall, the decline in consumption due to the price increase would amount to 3.8% or a decline of 670,000 gallons.

If flavored malt beverages were considered to be distilled spirits rather than beer products, it would limit the number of places that could sell this product. This would impact consumption especially in the off-sale market. We have not found much data on the percentages of these products sold at convenience stores or other retail outlets that have only a license to sell beer and wine. However, what information we have found leads us to believe that the portion is large. If we assume that half of these products are purchased in retail stores having only beer and wine licenses, and if we assume that two-thirds of those purchasers will not take the trouble to go to a store that sells all types of liquor, then there would be a decline in consumption of 4,357,000 gallons.

The above two factors would mean that there would be a decline in consumption from 17,445,000 to 12,418,000 gallons. The current excise tax revenue from flavored malt beverages amounts to \$3,489,000. The excise tax revenue from the estimated consumption of flavored malt beverages if they were considered to be distilled spirits would be \$40,979,000. This would be a revenue gain of \$37,490,000.

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The portion that would be deposited into the Youth Alcohol Problem Prevention Fund would be \$16,143,000. (12,418,000 gallons x \$1.30 per gallon = \$16,143,000). The increase in revenues that would go to the General Fund would be the tax rate on distilled spirits (\$2.00 per gallon) minus the current amount of tax collected on these products. This would amount to \$21,347,000. ([12,418,000 gallons x \$2.00 per gallon] minus [17,445,000 gallons x \$0.20 per gallon] = \$21,347,000)

If flavored malt beverages were considered to be distilled spirits rather than beer products, the manufacturers of those products might decide to reformulate their products. Or they might continue to produce the current products in a smaller quantity and develop new products that would meet the definition of beer products. There is no way for us to predict the industry's response.

Revenue Summary

The revenue gain from considering flavored malt beverages to be distilled spirits rather than beer products would include an increase in excise tax revenues as well as an increase in state and local sales tax revenues. The revenue gain would be as follows:

Excise Tax Revenue Increase

Youth Alcohol Problem Prevention Fund	\$ 16.1 million
General Fund	21.4 million
Total	\$ 37.5 million
State Sales & Use Tax (at 5.25%)	\$ 2.0 million
Total State	\$ 39.5 million
Local Sales & Use Tax (at 2.00%)	\$ 0.8 million
District Tax (at 0.67%)	\$ 0.3 million
TOTAL	\$ 40.5 million

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